

**United Way of America Response to  
Senate Finance Committee White Paper on Proposed Nonprofit Reforms**

The following outlines United Way of America's (UWA's) position on most of the items in the Senate Finance Committee White Paper.

**A. EXEMPT STATUS REFORMS**

**1. Five Year review of tax exempt status by the IRS**

UWA supports this proposal as long as it does not become overly burdensome with regard to paperwork, and does not involve the imposition of new fees on nonprofit organizations.

The gathering and making public of information such as best practice policies and audited financial statements will allow the public to see more clearly the activities of a nonprofit than is currently possible from the Form 990. It will also allow nonprofits to learn from each other by comparing best practices and adopting those that are similar. However, the imposition of a processing fee to cover the cost of processing the information is something we cannot support. Such a fee would impose added cost on nonprofit operations, which would bring even more criticism of "overhead" costs and would be viewed by most as a "tax" on nonprofits, regardless of what it is called.

**2. Donor Advised Funds (DAF)**

1. Traditionally, the United Way experience in DAF contributions has been with cash and publicly traded securities. However, we believe that allowing only contributions of cash or publicly traded securities would be too limiting and would prefer that the legislation reflect a plan for accepting alternatives.
2. We agree with the intent and language of the grant-making limitations.
3. We agree with the intent of acknowledgement of lack of private benefit but would hope for better definition of "private benefit" to eliminate any confusion.
4. Although we can appreciate the intent of Item 4—the payout requirement—we feel that it is too limiting to be appropriate. Our experience with DAF indicates that some donors use them as a vehicle for windfall profit distribution and want to see a much higher rate of distribution; others want to see their principal grow until it is sizeable enough to have significant impact. By setting the payout requirements to match those of foundations, it appears that the gift would exist until perpetuity. This is not the intent of many DAF

contributors. We suggest that the 5 percent rule—if necessary—be applied to the total distribution of the charitable fund, not the distribution of any single individual. There should be some specific guidelines that regulate individual donors (some organizations use a seven-year activity cycle), but in our opinion the five percent rule is too limiting for an individual.

5. It is not clear whether this language defines activities as including contributions. If other definitions are in place, this may be redundant and confusing.
6. This request is reasonable although it would hurt those who use their DAF to support anonymous giving.
7. The proposed method of identifying nondomestic outlets for charitable contributions allows for necessary consistency in nondomestic giving. The IRS list will need to be vigilantly maintained in order to support current global charitable needs.
8. We agree with the intent and language of the grant usage (for pledge fulfillment) and feel this is an important component of the legislation.
9. We agree with the intent and language of the investment manager hiring practices.
10. We agree with and find very reasonable the intent and language of the grantee selection due diligence costs limitations.
11. We agree with the intent and language of fee limitations for DAF referrals and transfers.

### **3. Supporting Organizations**

Although we have limited experience within the United Way system with Type III supporting organizations, we believe that there may be abuse in this area when individuals attempt to bypass the regulations of foundation distributions. We suggest the following verbiage: "Eliminate Type III supporting organizations except those set up between two non-profit organizations."

### **4. Revise exemption standards for credit counseling organizations**

UWA has no position on this issue at this time.

### **5. Revoke exempt status for accommodations to tax shelters**

UWA supports this proposal in principal, but the methods developed by the IRS for determining whether accommodation has occurred will determine whether or not it can be fully supported. One immediate suggestion for improving the idea is to add the word "knowingly" to the first sentence so that it would read, "... determined by the IRS to be knowingly accommodating parties..." If a nonprofit can demonstrate that

it did not know it was party to such a transaction, it should not be penalized.

**B. INSIDER DISQUALIFIED PERSON REFORMS**

A disqualified person is any person in a position to exercise substantial influence over the affairs of a nonprofit or family members of such a person. The definition includes the organization's president/CEO, CFO, and board members.

**1. Apply private foundation self-dealing rules to public charities and modify intermediate sanction compensation rules**

UWA has no position on this issue at this time.

**2. Expand definition of disqualified person**

UWA has no position on this issue at this time.

**3. Increase taxes for self-dealing, jeopardizing investments, and taxable expenditures**

UWA has no position on this issue at this time.

**4. Compensation of private foundation trustees**

UWA has no position on this issue at this time.

**5. Compensation of disqualified persons**

UWA agrees that salary levels of highly compensated individuals should be subject to regulatory oversight and board approval. However, it believes that with respect to public charities, the intermediate sanctions provide sufficient safeguards on compensation levels. Those regulations impose penalties on individuals receiving compensation outside of market levels and require board review and approval of such compensation in order to avoid director liability. This regulatory scheme requires organizations to examine and benchmark compensation levels on an annual basis in conjunction with expert outside consultants. Additionally, the public disclosure rules currently in place already require the compensation levels of the top managers and the corporate officers to be reported in the 990.

It is difficult to comment on the proposal to require additional supporting information for highly compensated individuals without more specificity about the nature of such materials. However, to the extent that the proposal contemplates mandating IRS review and approval of salary levels, this would be difficult to effectively administer in

light of the myriad of factors that affect the reasonableness of compensation levels. Such factors include position responsibilities, performance levels, organization size and market conditions which may be difficult to accurately assess at the regulatory level. Attempts to impose such a requirement are likely to result in a standardization of salary levels that would hinder the ability of charities to attract and retain top talent.

**C. GRANTS AND EXPENSE REFORMS**

**1. Treatment of administrative expenses of nonoperating foundations**

United Ways as a system have low administrative costs (approximately 12.7 percent, according to our latest data). However, establishing a specific percentage for maximum administrative costs (e.g., 35 percent of total expenses) may be a dangerous precedent for some organizations with legitimate reasons for having higher administrative costs. Some administrative functions, including internal audits for example, are necessary to assure proper stewardship of nonprofit resources. In the context of private, non-operating foundations, this rule would not affect most nonprofits, but once established, it may lead to establishment of such a rule for other/all nonprofits.

**2. Encourage additional grant-making by foundations**

UWA has no position on this issue at this time.

**3. Prohibit foundation grants to donor advised funds**

UWA has no position on this issue at this time.

**4. Limit amounts paid for travel, meals and accommodations**

UWA appreciates and endorses more stringent standards for travel/meal/accommodations expenses. We would be interested in verifying the limitation definitions surrounding market equity and events. For example, meal and accommodation costs vary greatly between markets (NYC hotel costs do not compare with those in Springfield, MO). Also, this legislation does not appear to include event costs.

**D. FEDERAL-STATE COORDINATION OF ACTIONS AND PROCEEDINGS**

**1. Establish standards for acquisitions/conversion of a nonprofit**

UWA has no position on this issue at this time.

**2. Provide states the authority to pursue federal actions**

UWA agrees that there should be coordinated oversight of charities at the federal and state level. Currently, state laws governing charities vary from jurisdiction to jurisdiction and are enforced in an uneven manner. However, providing states the authority to pursue federal violations may create even greater inconsistencies in enforcement activities. Rather than giving states the authority to pursue federal violations, states should be encouraged to adopt more uniform standards for the operation of charities.

**E. IMPROVE QUALITY AND SCOPE OF FORMS 990 AND FINANCIAL STATEMENTS**

**1. Require signature by Chief Executive Officer**

UWA agrees that the CEO should be responsible for establishing policies that will ensure that the 990 is prepared correctly. This is a membership requirement for all United Ways. However, many CEOs do not possess the expertise to determine whether the Form 990 complies with the IRS code. Therefore, UWA recommends that both the CEO and the CFO sign this statement. The CFO is usually better positioned to understand whether the information is "true, correct and complete." The CEO's supervision of the CFO serves as his/her method for establishing policies that ensure proper preparation.

**2. Penalties for failure to file complete and accurate 990**

Adding a separate penalty for "each failure to include required information" is more stringent than is necessary, particularly for what in many cases could prove to be simple oversights. Before increasing financial penalties or adding new ones, we recommend that the IRS enforce the current penalties allowed to them. Also, the 990 form must be revised so that commonly missed "boxes" (like "Joint Costs," currently sandwiched between parts II & III; question # 75, currently hiding at the bottom of page 4 below part V; etc.) are repositioned in more prominent places on the form.

**3. Penalty for failure to file timely 990**

UWA agrees with this proposal. Our own membership standards require all United Ways to file within 9 months of the end of the fiscal year, which is only 15 days more than the proposal, so it should not be difficult for our members to conform.

**4. Electronic filing**

UWA agrees with this proposal. However, it should be noted that it will take time to implement electronic filing successfully. Even if the IRS is capable of accepting forms electronically by 2006, utilization may still be very low because there are currently too few software providers willing to create low-cost, user-friendly software that will assist nonprofits in preparing an electronic form.

**5. Standards for filing**

UWA has already established such standards for its membership. However, because of the genuine differences between various types of nonprofits, there will need to be a number of variations on the standards. It may serve the public best if broad, general standards are created and then, where specific groups of "similarly situated charities" exist (e.g., United Ways, YMCAs, Red Cross Chapters, etc.), they self-impose sector specific standards that have been "approved" by the IRS.

**6. Independent audits or reviews**

UWA agrees with the proposal to require financial audits for organizations with gross receipts in excess of \$250,000 and reviews of organizations with gross receipts between \$100,000 and \$250,000. We already hold our members to a higher standard. Given the 990 requirement to reconcile differences with financial statements, such a requirement would help assure the accuracy of financial information reported on the 990.

UWA does not support separate certification of an auditor review of the 990 and/or annual financial reports because they contain nonfinancial information with which they have no expertise.

Also, while UWA has also recommended that members attempt to change auditors every three to five years, we cannot support a requirement to change every five years because in small communities there may be only one auditor who will do audits for nonprofits. Thus, making the change mandatory may be an impossible standard with which to comply.

**7. Enhanced disclosures of related organizations and insider transactions**

We agree with this proposal. Greater disclosure will create greater transparency and accountability.

**8. Disclosure of performance goals, activities, and expenses in Form 990 and in financial statements**

We agree with the spirit of this proposal. Our new membership standards advocate including this information as an attachment to Section III of the 990. We consider Section III to be the most important part of Form 990 because it helps donors determine if United Ways are accomplishing their goals and are therefore worthy of the donors' continued support. However, given that the 990 is a document intended to report on historical results of operations, we do not believe that this is the proper instrument to be used by an organization to describe its goals prospectively.

#### **9. Disclose investments of public charities**

UWA has strong concerns with this proposal because of the potential burden it may place on charities. For nonprofits with extensive trading activity, the additional burden of reporting on each transaction could prove to be extremely costly. In addition, most nonprofits have some form of investment but, because it is not a primary part of their daily business, they often "outsource" management of investments to companies that specialize in this activity. While it is common for the nonprofit to establish a policy regarding the type of instruments that are invested in, it is uncommon that restrictions are placed on the specific issuer of the instruments traded. They may unknowingly be investing in entities that donors would react adversely to and even cause them to withdraw support. In addition, for nonprofits with extensive trading activity, the additional burden of reporting on each transaction could prove to be extremely costly.

### **F. PUBLIC AVAILABILITY OF DOCUMENTS**

#### **1. Disclosure of financial statements**

UWA supports this proposal. More disclosure, in the right format, creates greater transparency and accountability. However, please note that many nonprofits have already begun to voluntarily disclose their financial statements (we recommend it to our members as a transparency "best practice," and thus, legislation may not be necessary).

#### **2. Web site disclosure**

UWA supports this proposal, but we wonder why financial statements would be required for five fiscal years while 990s are required to be made public for only three.

### 3. Publication of final determinations

UWA supports this proposal if an exception is made for voluntary disclosures to the IRS, thus protecting the identity of the organization that willingly admits its errors and voluntarily takes corrective action.

### 4. Require public disclosure of Form 990-T and affiliated organization returns

UWA supports this proposal.

### 5. Require public corporation filing of charitable giving return

UWA opposes this proposal. It may place an undue burden on public corporations, causing them to limit their giving to nonprofits.

## G. ENCOURAGE STRONG GOVERNANCE AND BEST PRACTICES FOR EXEMPT ORGANIZATIONS

### 1. Board duties

UWA recommends that provisions establishing federal liability for breach of board member duties be stricken from any proposed legislation. Such provisions may negatively impact a charitable organization's ability to recruit good board members. Current statutes already address criminal acts.

- *Compensation:* UWA supports efforts to subject compensation to additional oversight provided that this is only an expansion of what is already in the Form 990 (Part III & Schedule A) and that such provisions provide sufficient flexibility to allow executives to set pay levels for individual employees. It also should be noted that compensation levels are already subject to regulatory oversight through the intermediate sanction rules in Part III in Schedule A.

To ensure that the board as a whole is not weighed down with the administrative details of the executive compensation process, it is recommended that charitable boards have the ability to designate board-level committees, such as an executive committee or an executive compensation committee. This would include the authority to manage the executive compensation process, including hiring and oversight of the activities of a compensation consultant.

Also, because the board often does not directly interact with each member of the management team, it has limited ability to make an informed decision about each member's compensation. UWA recommends that the board approve salary ranges for all management positions. The ultimate compensation decision would remain within the charitable organization's staff hierarchy.

- *"The Board must establish basic organizational and management policies and procedures of organization and review and proposed deviations."*

This provision would interject the board into the day-to-day operations of the organization, a practice that does not provide additional accountability but, rather, could hamper the efficient workings of the charitable organization.

- *"The Board must establish, review, and approve program objectives and performance measures and review and approve significant transactions."*

UWA supports this proposal.

- *"The Board must review and approve the auditing and accounting principles and practices used in preparing the organization's financial statements and must retain and replace the organization's independent auditor. An independent auditor must be hired by the Board and each such auditor may be retained only five years."*

UWA supports this idea provided the board be given the flexibility to delegate this function to a board-level Finance and Audit Committee. By charging all board members with the responsibility to review and approve financial practices and standards and hire the organization's independent auditor, the Senate Finance Committee may restrict the types of individuals who would agree to serve on charitable boards to certified professional accountants.

While UWA has also recommended that members seek to change auditors every three to five years, we cannot support a requirement to change every five years because in small communities there may be only one auditor who will do audits for nonprofits. Thus, making the change mandatory may be an impossible standard with which to comply.

- *"The Board must review and approve the organization's budget and financial objectives as well as significant investments, joint ventures, and business transactions."*

UWA supports this proposal.

- *"The Board must oversee the conduct of the corporation's business and evaluate whether the business is properly managed."*

Boards are already responsible for such oversight. UWA supports board oversight over the conduct and evaluation of the organization's business through its evaluation of the chief executive.

- *"The Board must establish a conflicts of interest policy (which would be required to be disclosed with the 990), and require a summary of conflicts determinations made during the 990 reporting year."*

Potential conflicts involving several specific types of activities are already required to be disclosed in part III of Form 990 (question #2). Certainly, it is important for the charitable organization to be aware of these conflicts of interest so that it makes proper decisions. However, by disclosing a summary of each conflict publicly, the charitable organization may be raising public concern where none is really warranted if the organization takes appropriate measures to manage them.

- *"The Board must establish and oversee a compliance program to address regulatory and liability concerns."*

A program to oversee regulatory and liability concerns is a good practice for charitable organizations. However, not all board members have the legal expertise to do this work effectively. UWA recommends that the charitable organization as a whole be charged with this work and that the board be made familiar with the program via staff reports.

- *"The Board must establish procedures to address complaints and prevent retaliation against whistleblowers."*

It is sound business practice to establish a grievance process. However, since this activity is operational in nature, it is recommended that the board be charged with establishing general policies on whistle blowing, while staff (i.e., the general or legal counsel) be charged with implementing policies established by the board. Such a process must guarantee that whistleblowers are protected to the full extent of the law.

## **2. Board composition**

UWA opposes limiting boards to a maximum of 15 members. This range is too small for a charitable board to do its work effectively. The boards of most charitable organizations conduct their business via board-level committees. Common committees cover such areas as finance, governance, human resources and compensation, program, and resource development. By limiting the number of board members to 15, the Senate Finance Committee may hinder the effective functioning of board-level committees. Also, for many organizations, maintaining representation from each of the various constituent groups in a community requires a larger board.

### **3. Board/Officer Removal**

- *Prohibition on Services*

UWA supports this proposal.

- *IRS Authority*

UWA opposes this proposal. This provision effectively removes the board's ability for self-governance. While it is noted that the situations cited in the recommendations are serious breaches, the Senate Finance Committee could minimize these instances by requiring that the boards of charitable organizations include provisions for the removal of board members and officers in their bylaws (which many of them already do). If the charitable organization then violates this provision, then the IRS would have the ability to pursue corrective action.

### **4. Government Encouragement of Best Practices**

UWA strongly supports sharing and promotion of Best Practices within the nonprofit sector but because the IRS is primarily a law enforcement agency, they are not a good choice for promoter.

### **5. Accreditation**

UWA opposes government mandated accreditation because there are genuine operating differences between nonprofits (e.g. a United Way is very different from a Red Cross Chapter). Rather, we believe that the public is better served by nonprofits self-imposing stringent operating standards. UWA already imposes strict standards on its member organizations. Those that do not comply lose their status as a United Way member. These standards do not conflict with separate, state-level accreditation efforts. United Way of Central Maryland, for example, is one of just 44 organizations that have been

accredited by the Maryland Association of Nonprofit Organizations' Standards for Excellence Institute.

**6. Establish prudent investor rules**

UWA has no position on this issue at this time.

**H. FUNDING OF EXEMPT ORGANIZATIONS AND FOR STATE ENFORCEMENT AND EDUCATION**

UWA is generally supportive of the funding suggested by the White Paper but strongly opposes generating such funding with a filing fee for the Form 990 or increased penalties. Unlike for-profit organizations, nonprofits are not able to pass on added costs to the consumer. Nonprofits exist at the will of donors who are already critical of operating costs, which would be increased by such mandatory fees. Any required funding should be provided from appropriations.

**I. TAX COURT EQUITY AUTHORITIES, PRIVATE RELATOR AND VALUATION**

**1. Tax Court Equity Authorities**

UWA opposes this proposal. The provision of equitable powers to the tax court to substitute trustees, divest assets and enjoin activities hinders the ability of an organization to govern itself and exercise business judgments. Courts would be placed in the position of being able to substitute their judgment for that of the governing body specifically chosen for that purpose. This would force organizations to make business decisions that are not necessarily in the best interests of the organization, but rather to avoid judicial review and potential exposure. While arguably this may be appropriate in extremely egregious situations, it should not be a readily available remedy.

**2. Private Action - Directors**

Allowing directors to sue on behalf of an organization at the organization's expense is a remedy that could be subject to great abuse. Aggrieved board members could use this as great leverage to influence or gain control over board actions. The threat of legal action and payment of legal fees could inappropriately become the deciding factor in business decisions. If this proposal is adopted, appropriate safeguards and standards should be in place to prevent such abuse. This private action should be a last resort for directors who have exhausted all organizational provisions for grievances

**3. Private Relator Action - Individual**

UWA supports the proposal to assess a filing fee and fines for frivolous filing of complaints against nonprofits.

**4. Valuation Resolution**

UWA has no position on this issue at this time.